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A CRITICISM OF THE OHIO LAW OF WORKMEN'S COMPENSATION INSURANCE

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By

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Address before The Business Men's Club of Cincinnati, January 18th, 1913, by P. Tecumseh Sherman, of New York.

Our old law of negligence as between employers and their workmen has been most unsatisfactory for many reasons. It has engendered class feelings of mutual hostility. It has been slow, uncertain and wastefully expensive in operation. But above all it has been unjust to the workingmen, because it has made them bear all the loss from injuries due to the ordinary and unavoidable risks of their employments, whereas, according to the latest theories of justice, the wage-loss therefrom should be borne by the business of the employer, (and, if possible, passed on to the consumers of his product or service). Reverse that rule of assumption of risks in our common law of negligence—thereby making employers in hazardous industries liable for about five accidents out of ten, instead of for about one out of ten—and you have approximately the compensation law in the abstract.

But in its applied form the compensation law departs yet further from the negligence law. Because it is impracticable to determine as to each occupational injury whether it was due to employer's fault, to injured workman's fault, to a trade risk, or partly to one and partly to another—for that would result in excessive uncertainty, delay, wasteful expense and many erroneous decisions,—the compensation law resorts to a rule of average, and—holding the employer responsible for about half of all accidental work-injuries in his employment in the mass—makes him liable to pay half the estimated wage-loss from each work-injury in the particular. That rule, with various modifications, has been adopted generally throughout the rest of the civilized world, and is now being adopted in the United States. Wherever tried it has come to be considered more *just* both to employers and to workmen than the former law of negligence, which it replaced.

But I approached this reform from another direction. I was formerly Commissioner of Labor and ex-officio Chief Factory Inspector of the State of New York. In studying the problem of industrial accident prevention I soon discovered that it is the prevailing opinion of European experts, that, to relegate employers' liability for injuries caused by real wrongdoing to the *penal* law, and to so frame the *civil* law as to hold each employer and his workmen

jointly and equally responsible for all ordinary accidents, and consequently to make the employer pay half the wage-loss and the injured workman suffer half the wage-loss from every ordinary occupational accident, *certainly* and without chance of escape by the gamble of a law suit, is the best known regulation to reduce accidents in organized industries.

To be most effective for that purpose the scale of compensation should follow the theory just stated, and be approximately 50% of the wage-loss,—which should be proportionately increased only where workmen contribute or where the limitations on the pension payments are short or low. A few of the European laws give low flat rates of compensation, without relation to wages; but they are really measures for poor relief, and admittedly have no relation to justice and little or no effect in the way of accident prevention.

Therefore a 50% compensation law should be the substitute for our law of negligence between industrial employers and their workmen; and it should be regarded both as a measure of private justice and as a public regulation for accident prevention.

But in addition to these two purposes, a proper compensation law should be most effective for general social relief, for it should practically assure injured workmen and their dependents against destitution from occupational injuries.

Elective compensation laws (such as have been adopted in many of our states) are merely makeshifts to avoid a constitutional doubt or difficulty, and consequently should be regarded merely as temporary expedients on the way to compulsory compensation.

None of the foreign laws are elective; all are compulsory. And generally they entirely replace the former law of negligence. Some of them, however, leave the employer still liable for full damages for injuries due to his serious or wilful faults; but when they do so they also deny compensation to workmen injured through their equal faults—in other words, such laws are equally as fair to employers as to workmen. The net result of such excepted cases has been to increase litigation and the cost of insurance a little; and the weight of opinion inclines towards making the liability for compensation general and exclusive.

Now as to insurance.

Insurance is no more an essential feature of the compensation law than it is of the negligence law. We should therefore keep the problem of insurance distinct from the problem of framing a compensation law; and should first formulate our compensation law and then decide what provisions for insurance are desirable.

Insurance should have two purposes: (1) For the employers' benefit—to indemnify them, or (speaking technically) to distribute their risks. (2) For the injured workmen's benefit—to guarantee to them the payment of their compensation.

But insurance in practice under our law of negligence has generally been defective as regards its second purpose:

First. Because formerly it indemnified the employer only *against* his workmen, so that, for example, if an employer became bankrupt and did not pay his liability the insurer was not liable and the injured workman derived no benefit from the insurance.

Second. Because insurance has generally been limited in amount; and that amount often less than the liability of the employer. That divides responsibility and leads to abuses to the prejudice of injured workmen.

These abuses have been or must be corrected. To correct them it should be required by law that all employers' liability insurance shall run directly for the benefit of the injured workmen, and that an insurer shall never underwrite less than the employer's *entire* compensation liability.

But there is a specific danger under the compensation law that insurance may thwart its purpose as a regulation for accident prevention. If an employer with a high risk is enabled to insure his liability at the same rate as a competitor with a distinctly lower risk; or if an employer with a low risk is compelled to pay for his insurance the same rate as a competitor with a distinctly higher risk, the effect of the compensation liability, as an incentive to the employer to study out methods and to incur expense to decrease his risks in order to cut down his rate of insurance, will be defeated. The cost of his insurance is the civil penalty each employer pays for maintaining the hazards of his business; and to be effective for accident prevention that cost must be closely proportionate to those hazards.

Therefore insurance rates must be differentiated fairly for each industrial establishment according to its comparative risks, as determined both by experience and by physical and moral conditions. And in return for premiums paid the insurer should furnish expert and beneficial inspection.

Finally, insurance must be sound. Employers should not pay for insurance, and then have it happen either that they are unexpectedly subjected to a further charge or liability, or that their injured workmen do not receive the benefit of the insurance.

In my opinion insurance of compensation should not be made compulsory except when and where that may be found by experience to be necessary to

secure to the injured workmen their rights under the law. Railroads and other large establishments, which have their risks well distributed, may properly carry their own insurance; and it would be a pure economic waste to compel them to insure simply to round out a paper scheme. And English experience indicates that it is not necessary to make insurance obligatory in order to secure relief to the injured. In England, where insurance is voluntary, experience shows that employers generally insure of their own free will, so generally that there is almost no record of loss of compensation by workmen on account of the bankruptcy of employers.

But the American working people seem to be distrustful of experience, and demand the more obvious guarantee of compulsory insurance. If, to satisfy them, insurance should be made compulsory, at least those employers whose ability to carry their own risks is beyond question should be exempted, and the other employers, who are required to insure, should be allowed a wide choice in methods of insurance. Otherwise we would run into the evils of monopoly or near-monopoly and the danger of ruining all—the wise and the foolish alike—in a single scheme of unsound insurance. The large majority of foreign countries give employers a wide choice as to how they shall insure. That has the advantage of satisfying a larger proportion of employers than if one particular method of insurance were prescribed without alternative (and where the compensation law is elective of bringing under it many who would otherwise stay out), of testing all methods of insurance, and at the same time of guaranteeing the workmen.

But all methods of insurance that are permitted—whether in a state insurance office, in a mutual association, or in a stock company—should be subjected to state regulation and to equally stringent requirements as to reserves and public reporting.

Now as to the cost of insuring compensation. Under the compensation law employers must pay something for over 99% of all injuries lasting over a short excepted period of—say—two weeks; whereas under negligence laws employers need not pay anything on account of more than about 20% of such injuries. Consequently, although the amounts payable under the compensation law are limited, yet the aggregate is very much greater than under the negligence law; and when employers come to insure compensation they will not be able to insure for a limited amount, but must cover their aggregate contingent liability in the event of disaster. Therefore insurance of compensation will cost on the average between three or four times as much as insurance against the liability for damages. In England the change from the negligence law to the compensation law increased rates at once about six times; and experience

has shown that that was not quite enough. But our proportionate increase should not be quite so great. There are various schemes of insurance which, it is pretended, will avoid this increased cost. But they cannot avoid it—they can merely defer it and cause it to accumulate into a crushing burden of indebtedness later.

So much for general principles. Before taking up the Ohio law let us first consider briefly the Norwegian law after which the Ohio law is modeled.

In Norway the state itself has assumed the liability to pay compensation for industrial injuries; and it taxes employers, at rates graded according to a rough estimate of the degree of risk in their respective trades, to maintain a fund out of which the payments are made. Government officials do everything—manage the fund, fix the rates for the various trades, assign the employers to trade classes, investigate claims and decide and pay the awards. The employers are discharged from all responsibility for accidents when they have paid their annual premiums; if the premiums prove to be insufficient, the state loses, and the taxpayers generally must make good the deficiency. That happened once; and there was a serious political struggle before it was settled who should be taxed to make good the deficiency. This monopolistic method of insurance effects some saving by eliminating the expenses of competition and by the free use of existing political machinery in administration; and therefore in a thinly populated country with widely distributed petty industries, like Norway, it is not without theoretical advantage. But in economy it does not compare with voluntary mutual insurance; and in comparison with stock company insurance in Great Britain, it is cheap only for the bad risks, while more expensive for the good risks. And, on the other hand, it is subject to the following objections which are prohibitive to its use in an industrial state.

(1) It has resulted practically in a "flat" rate for all employers in each trade, without proper regard to the variations in hazards in the different establishments. That is not only most unjust to the better employers; but also, by relieving the individual employer from all pecuniary responsibility for accidents in his business, it is the opposite of conducive to accident prevention. Consequently this law is condemned by practically all industrial experts.

(2) It places employers at the mercy of political officials as to which of several trade classes they respectively may be assigned to, and consequently as to which of several widely different rates they may be taxed. This is a subject of frequent disputes and much bitterness.

(3) The allowance of claims and the adjustment of awards are absolutely in the discretion of political officers. Employers have nothing to say about the management of the fund or the allowance of claims against it—although

they pay the bills. European experience generally indicates that this practice results in laxity in precautions against fraud and exaggerations, and in a tendency on the part of officials to misuse their powers to distribute political favors or charitable relief at employers' expense.

(4) It breaks the direct relation between employers and their injured workmen, and thereby not only propagates a spirit of undue dependence upon the state, but also leads to the expensive consequence, that whenever the efficiency of a workman is partially reduced by injury, instead of being employed by his employer at a lighter task and at reduced wages, and then compensated for the reduction in wages only, he is cast out altogether and established as a full pensioner upon the insurance fund.

Without going further into details, this method of insurance may be fairly described as a crude scheme to avoid the difficulties of adjusting and securing private rights and liabilities between employers and employees by turning the whole matter of compensation over to a political bureau with power to tax employers and to distribute the proceeds among employees about as it pleases. If this be good practice in regard to compensation, why should not life, fire and marine insurance, commercial contracts, and all other private rights and liabilities be adjusted and secured in the same way?

The Norwegian law was one of the earliest of the compensation laws; and yet it has never been copied in Europe—for the reason that it is generally condemned by industrial experts. The principal defects of that law arise from the monopoly of the insurance. Therefore all other countries which maintain state insurance offices allow employers to insure in other ways, at their election. In some four or five countries state insurance is maintained in competition with various forms of private insurance. In such competition, its relative inefficiency has been clearly demonstrated, and it is either losing ground or being sustained by public subsidies and legal privileges.

Now, with the principles of the compensation law and foreign experience in mind, let us take up the Ohio Law.

First. That law gives the State Board a monopoly of compensation insurance—for those who elect compensation must insure with that Board. Under an elective law that condition undoubtedly deters some employers who would otherwise elect compensation from doing so, and thereby deprives their employees of the benefits of the compensation law. And why establish a monopoly? Monopoly leads to laxity, comparative inefficiency, and to indifference to incidental abuses, injustices and defects, which would be cured under the stress of competition. Perpetuate the theory of the existing Ohio

law, and, when it is made compulsory, *all* the industries of the state will be placed at the mercy of a political monopoly, to be "taxed" at its discretion, without check or supervision. Even in Norway the railroads, the only concerns there large enough safely to carry their own risks, are exempted; while in Ohio all establishments, without need or reason, will have to pay tribute to your bureaucratic scheme. Certainly the better classes of employers—those with relatively low risks—would always be dissatisfied with that scheme, for it would result generally in their being treated closely on a par with their more negligent competitors. There is no necessity for embracing this certain evil. Why not first try out the various methods of insurance in competition, and learn from experience which are the better, before giving a monopoly to that form which foreign experience indicates to be the worst?

Second. The Ohio law leaves the allowance of claims and adjustment of awards absolutely to the discretion of political officers—with the exception that the claimant, in certain cases, may appeal to the courts. It is obvious from this provision that the working people were unwilling to be subjected absolutely to the power of such officials. Why then in common fairness should employers be, when ultimately they are to pay the awards? Experience everywhere indicates that this practice results in extreme laxity in guarding against fraudulent impositions and exaggerations, and in a tendency on the part of the officials to misuse their powers to distribute political favors or charitable relief at employers' expense. Awards of compensation operate to deprive employers of their property, and therefore employers should have an opportunity to be heard and to present the facts before awards are made or increased. Bear in mind that malingering is the bane of the compensation laws, and that unless an elaborate system of checks upon impositions is maintained (and there is no sign of a check in the Ohio law or in the practices of the Ohio Board) there will be as great a proportion of parasites living in idleness off your compensation law as there are unworthy beneficiaries under our National Pension Laws. Nor is it right that the same officials who fix rates and collect the fund should also determine the awards against the fund. Should they, for example, fix rates too low to raise sufficient to meet their liabilities, it would be too easy for them to hide their mistake by scaling down awards unduly so as to make ends meet, regardless of the exact rights of the injured claimants. These two functions are incompatible. To confide them both to one set of officials is practically to invite perversions of the law.

Third. Foreign state insurance is always sound, because the state itself assumes the obligation and pledges its credit to pay the compensation. But under the Ohio law the state assumes no obligation and guaranttes nothing.

No one is liable for a deficiency if one occurs;—the employers are discharged (probably—but if not, they are being fooled), and the officials are irresponsible. Consequently, in case there should be a deficiency, there is no assurance that the injured workmen, who have received awards, will be paid. Foreign experience has been that the true cost of a compensation law is not ascertainable for several years,—the injured workmen do not learn to put in their claims, impositions do not arise, and the cost of surveillance, adjustments, etc., does not begin to be realized until then. Therefore when the Ohio Board, after a few months petty experience, boasts that it can sell insurance at about half the rates figured out by all experienced actuaries, it seems only too probable that it is treading the path foreign state insurance offices have trod, and is heading straight towards a deficiency—towards trouble for the State of Ohio. Private insurance companies abroad have had only a little less unfortunate experience,—they all put their rates too low at first. But such companies have had to pay for their mistakes out of their own capital; whereas for the mistakes of the foreign state-insurance officials the public has had to pay. But in Ohio the question, who will pay for the actuarial mistakes of the State Board, is blindly left for the future to answer. Politically that is dangerous; and it is not insurance.

Fourth. Foreign experience shows that state insurance is not *cheap*—particularly not for the employers with low risks. In Norway the cost of administering the insurance (which is paid by the state) is, it is true, kept very low. But the rates of insurance charged to employers average about as high as in Great Britain (where insurance is private and the rates cover expenses of administration); and, being flat, the rates in Norway are higher for the better classes of establishments than in Great Britain. Monopolistic state insurance has the obvious advantage that it eliminates the cost of competition, etc.; but even with this item of saving it is no cheaper, *net*, to employers than private insurance; and to offset any possible advantage in this line, it entails a heavy expense upon the public.

Fifth. State managed insurance never results in a proper differentiation of rates in proportion to hazards. Inability to differentiate rates properly, through comparative inefficiency, has been obviously demonstrated where state-insurance offices are in competition with private insurers. In Norway, where the state has a monopoly of compensation insurance, the officials have refused to discriminate between establishments on the ground that to do so would subject them to accusations of and to appeals for favoritism. Moreover, the Norwegian insurance office is bent on cheapness of administration, and to succeed

in that direction has been led to dispense with the inspection force requisite to differentiate rates properly.

It is argued that the failure of the state-insurance offices to differentiate rates is simply accidental, and that a state bureau might do so as well as a private company or mutual association. The answer to this contention is that a state insurance office cannot do so without sacrificing its claims to cheapness. Public service is more expensive than private service; and if the state furnishes a service *equivalent* to that of private companies or mutual associations it will cost more. Moreover state inspection is never so expert or responsible as private inspection. The public factory inspectors of Europe, although of high grade, do not rank with the inspectors of the English private insurance companies and of the German trade mutual associations, who are undoubtedly the greatest factors for successful accident reduction in the world.*

The Ohio Board, however, claims that it can differentiate rates properly without inspection, solely upon experience—that is upon the past records of establishments in the way of accidents. That is absurd. No one would insure a boiler, an elevator or a flywheel on its past record. And that practice holds out no inducement to improvements. The Ohio board has been driven to make this absurd claim in order to gloze the fact that it has no force competent to inspect.

Incidentally this reveals another defect of the Ohio insurance. The average small employer has no one expert enough to inspect his elevators, boilers, flywheels, transmission machinery, etc., and he needs such inspection to protect himself against accidental injury to his plant and machinery, even if he be insured against all liability to his workmen. From private companies he receives such inspection, *guaranteed*, as an incident to compensation insurance, at little, if any, further expense. Under the Ohio plan he must go without such inspection, or procure it at heavy extra expense.

Sixth. The Ohio compensation law leaves employers liable for full damages under the negligence law for injuries due to violation of statute or ordinance by the employer or *by any of his employees;* (see the statute, section 21-2, where the word "agents" is used meaning "employees"). So that if a workman—without any fault on his employer's part—violates a statutory regulation or ordinance for safety, in consequence whereof he and some of his fellow workmen are injured, those fellow workmen may hold the employer liable in full damages as if for a wrong (for which liability he is uninsured),

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*The objections to state-managed insurance are well stated in the Report of the Congressional Employers' Liability and Workmen's Compensation Commission, pp. 56-8, in the Report of the Industrial Accidents Commission of Pennsylvania, p. 2, and in the Report of the Connecticut State Commission on Compensation for Industrial Accidents, pp. 4-7.

while the real wrong-doer is insured compensation at his employer's expense. And even where an employer has done his best to comply with the law, he nevertheless may be held, rightly or wrongly, not to have complied with it, so doubtful is the exact method of complying with some statutory requirements. Thus, although the employer pays to insure compensation to his workmen regardless of *their* faults, he is himself uninsured (and according to the contention of the Ohio authorities forbidden in any way to insure) against the chances of litigation for damages whenever compliance with a labor law is in question. And, with the probability of injured workmen falling into the hands of "ambulance chasing" attorneys, that chance is serious, and subjects every small employer subject to the law to the constant peril of financial ruin. As has been stated before, that discrimination against employers is contrary to all compensation law precedents, since all the foreign laws treat the employers and employees with equal fairness. So far from being a true compensation law, the Ohio law should be entitled: "An act to perpetuate ambulance chasing." While the class of litigation to which these provisions of the Ohio law open the door may not yet have arisen, still it surely will arise when the opportunities they present become more widely known.

The Attorney General of Ohio has ruled that it is against public policy, and therefore unlawful, for any employer to insure against his liability for damages for violations of safety statutes and ordinances by himself or his agents. I am not competent to discuss the public policy of Ohio. But it certainly is not against *sound* public policy. No foreign law forbids it. The Ohio act makes the employer insure his workmen against *their* faults and violations of statutes. Why, then, is it wrong to allow him to insure himself against his own unintentional violations of statutes, and against his liability for violations of statutes by his agents? It is contended by the Ohio Board that that would be like insuring against a crime. Nonsense! This is a *civil* and not a *penal* liability.

The Washington law is an insurance law something like that of Ohio, only not so bad. Both the Washington and Ohio State Insurance Boards are seeking to attract employers by exceptionally low rates. But those are merely initial or trial rates, which, if foreign experience is any guide, not only cannot be maintained, but, because they will result in deficiencies, will lead to unduly high rates or calls for state subsidies later.

From these warning examples I turn now to the comparatively successful compensation laws.

The German "Industrial Accident Insurance Law" requires all the employers in each branch of industry to belong to a trade mutual association, organized to insure compensation to their workmen. These associations are

highly autonomous, fix the insurance rates for their members, and make and enforce their own safety regulations—all under governmental regulation. The insurance premiums are levied on the deferred assessment basis, that is, only enough money is collected annually in premiums to meet payments falling due during the current year and build up small emergency reserves, leaving the deferred payments on continuing compensation pensions to be secured by the joint and several liability of the associations' members. This scheme has many advantages and many disadvantages, of which time forbids a detailed discussion.* Originally, it was popular among employers, because its initial rates were low; but it is losing much of its popularity with employers for the reason that its rates now are unusually high and are steadily mounting. While the German Industrial Accident Insurance Law deservedly ranks high, yet its success is due more to its fitness for conditions in Germany, to perfection in details and in administration and to its co-ordination with other parts of a broad system of sickness, accident and disability insurance than to the essential merits of its scheme. And the difficulties in the way of adapting it to American conditions are practically prohibitive.

The British compensation law makes each employer directly liable for compensation to his injured workmen, and permits him to insure it or not as he chooses. Another type of compensation law common in Europe simply goes one step further than the English law, and requires the employer to *secure or insure* the payment of the compensation, in some one of several specified ways—insurance in stock companies, mutual associations, joint benefit funds and state insurance offices being the prevailing alternative methods of insurance. The distinctive features of these laws is that there is little or no bureaucracy and no monopoly of insuruance, but each employer is free to choose such insurance as he may prefer, and is not by law placed at the mercy of a political board or of a badly run mutual association. He may bargain for rates among competing insurers, may change his insurance where it is unsatisfactory, can secure a reduced rate in return for improvements, may join a mutual association if conditions suit him, by agreement with his workmen may establish a joint benefit scheme of insurance, or (where his risks are sufficiently distributed) may carry his own insurance. Under this system, in Great Britain for example, there are no political abuses, comparatively direct mutual relations between employers and their injured workmen are maintained, there has developed a system of rate differentiation based upon expert inspection that has been a

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*For the objections to and difficulties in the way of adopting the German Industrial Accident Insurance Law, see the writers "Memorandum, Before the Industrial Accidents Commission, State of Pennsylvania."

powerful factor in reducing the hazards of industry, and insurance rates are relatively as low as anywhere else, in spite of the fact that in Germany and the state insurance countries the state pays a large share of the expenses of administering the insurance.

I, therefore, contend that the English law is in general the best model for us to follow—at least as a first step. If public sentiment demands compulsory insurance, then it is a very simple matter to add provisions requiring insurance. But if insurance be required, employers should be allowed to insure at their option in any sound and proper manner, and proper provisions should be adopted in our laws to regulate all sound and proper methods of insurance equally. In its general outlines the Michigan law fulfills this idea; but it is open to improvement in some particulars.